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IRS-Criminal Investigation Ramps Up Scrutiny Of Cryptocurrency Transactions

by Fox Rothschild LLP

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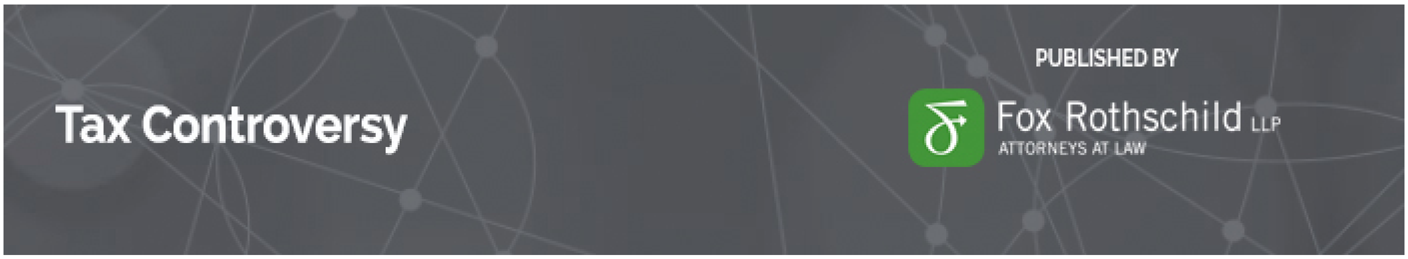

The Internal Revenue Service has assembled a specialized team of criminal investigators to build criminal tax evasion cases involving users of Bitcoin and other cryptocurrencies, according to a Bloomberg article entitled "IRS Cops Are Scouring Crypto Accounts to Build Tax Evasion Cases." In that article, David Voreacos writes that IRS Special Agents are pivoting from investigating taxpayers with secret offshore bank accounts to taxpayers with cryptocurrency accounts. Don Fort, chief of the IRS Criminal Investigation Division (IRS-CI), is quoted as saying that "It's possible to use Bitcoin and other cryptocurrencies in the same fashion as foreign bank accounts to facilitate tax evasion."

Last fall, IRS-CI announced that it was creating a new international tax enforcement group to focus on investigating and building criminal cases involving cross-border activity. According to the Bloomberg article, a newly-assembled team of 10 special agents in that group are now focusing not only on international crimes but also potential tax evasion using cryptocurrency.

As we have previously reported (here, here, and here), other federal agencies are tightening the regulatory framework surrounding cryptocurrencies and are launching vigorous enforcement campaigns to crackdown on fraud. Both the Securities and Exchange Commission and Commodity Futures Trading Commission have formed specialized enforcement groups to focus on cryptocurrency fraud, and have issued stern warnings to investors and consumers about the risks of cryptocurrency investments.

Last fall, the Internal Revenue Service has prevailed in its long-running dispute with Coinbase, the largest U.S.-based Bitcoin exchange, with a federal judge ordering Coinbase to comply with a "John Doe" summons seeking customer information. In an opinion issued on November 28, 2017, the court in San Francisco found that the government's narrowed request for information on Coinbase's customers served the legitimate purpose of investigating whether Bitcoin users

properly reported gains or losses on their income tax returns. The Court also found that the customer records sought by the government were relevant because they can be used by the IRS to determine whether a particular Coinbase customer is tax compliant. Coinbase must now hand over to the IRS records for accounts that had at least one transaction of at least $20,000 value during the period 2013 to 2015. According to Coinbase, this will require it to divulge trading records regarding nearly 9 million transactions conducted by over 14,000 customers.

Notwithstanding all of this enforcement activity, early data from federal tax filing season (which began January 29, 2018) suggests that cryptocurrency investors may not be properly reporting gains/losses on their 2017 federal income tax returns. Reuters reported yesterday on preliminary tax filing data from online tax service Credit Karma:

> Less than 100 people out of the 250,000 individuals who have already filed federal taxes this year through company Credit Karma reported a cryptocurrency transaction to U.S. tax authorities, the company said on Tuesday.
>
> This is despite nearly 57 percent of the 2000 Americans surveyed by the credit score startup and research firm Qualtrics last month saying they had realized some gains from cryptocurrencies, according to a Credit Karma study.
>
> Roughly the same percentage said they had never reported cryptocurrency gains to the Internal Revenue Service, while nearly half of those polled said they understood how owning cryptocurrencies affected their taxes, the study said.
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> The IRS considers cryptocurrencies such as bitcoin as property for federal tax purposes, meaning any profits or losses from the sale or exchange of the virtual coins should generally be reported as capital gains or losses.
>
> Trading of cryptocurrencies, digital tokens whose value is not backed by central banks and hard assets, surged in 2017 amid a rally in their price. A single bitcoin is worth more than $8000, compared with $1000 a year ago.
>
> Despite the surge it remains unclear how many Americans hold cryptocurrencies as these are bought and sold on online platforms, sometimes anonymously or using pseudonyms. US-based cryptocurrency exchange Coinbase says it has 10 million users, although it is unclear how many of these are in the U.S.
>
> Jagjit Chawla, general manager for Credit Karma Tax said the company was not too surprised that few people had reported cryptocurrency gains as Americans with more complex tax situations tend to file closer to the deadline.

> "However, given the popularity of bitcoin and cryptocurrencies in 2017, we'd expect more people to be reporting," Chawla said in a statement.

Credit Karma entered the online tax filing market last year, and about 1 million individuals filed their tax returns using Credit Karma's product.

[View source.]

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